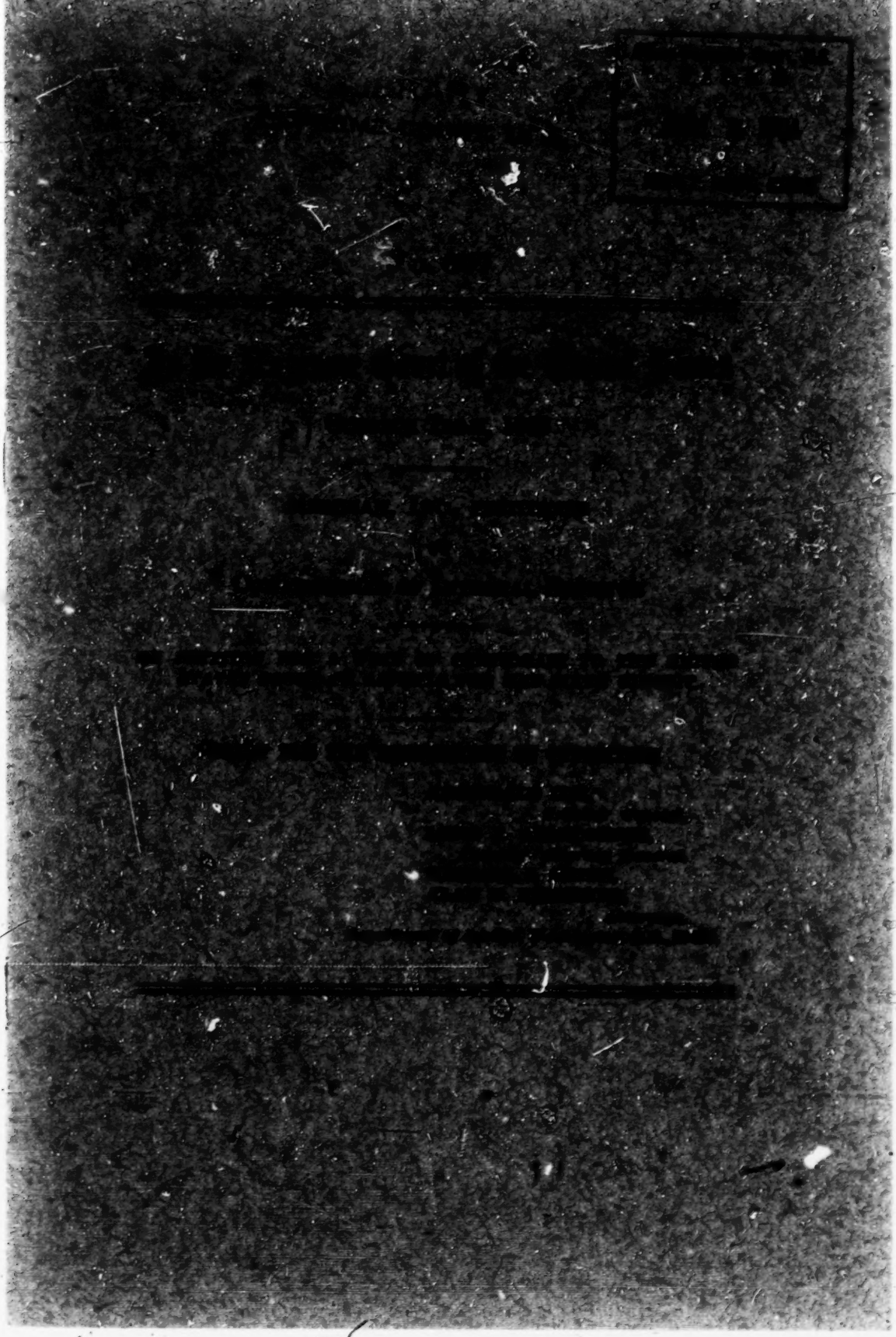

In the Supreme Court of the United States

OCTOBER TERM, 1963

No. 607

MERIDIAN, INC., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum findings of fact and opinion of the Tax Court (R.65a–78a)[1] are not officially reported.[2] The opinion of the court of appeals (Pet. 17–20) is reported at 322 F. 2d 198.

JURISDICTION

The judgment of the court of appeals was entered on September 4, 1963 (Pet. 21.) The petition for a

[1] "R." references are to the appendix to taxpayer's brief in the court of appeals.

[2] *Meridian, Inc.* v. *Commissioner*, decided March 20, 1962 (P-H Memo T.C., par. 62,059).

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writ of certiorari was filed on November 6, 1963. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the courts below correctly determined that real property sold by the taxpayer in 1954 was held primarily for sale to customers in the ordinary course of taxpayer's business and, consequently, that the profit realized from the sale was taxable as ordinary income rather than as capital gains.

STATUTE INVOLVED

Internal Revenue Code of 1954:

> SEC. 1221. CAPITAL ASSET DEFINED.
>
> For purposes of this subtitle, the term "capital asset" means property held by the taxpayer (whether or not connected with his trade or business), but does not include—
>
> (1) stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business;
>
> * * * * *
>
> (26 U.S.C. 1958 ed., Sec. 1221.)

STATEMENT

The taxpayer is a corporation organized in 1948. According to its corporate charter, one of the purposes for which it was formed was "To purchase, ac-

quire, hold, convey, lease, mortgage, or dispose of property, real or personal * * *" and its corporate objectives were, among other things, to secure building sites, to arrange financing by obtaining long-term mortgages, and to negotiate leases for buildings to be constructed by the DeBartolo Company, an associated company which was instrumental in organizing the taxpayer. These buildings were to be constructed at cost and according to plans and specifications provided by taxpayer and its tenants (R. 66a; Pet. 17).

From 1948 through 1961, taxpayer negotiated eight long-term leases, in most cases for fifteen years or more, with tenants of good financial standing. Five leases gave the tenant an option to purchase; a sixth option was given to a third party (R. 13a–14a, 19a–43a; Pet. 17). The five options to the tenants were exercised as follows (R. 13a; Pet. 17–18):

Transaction	Date of Lease	Date of Exercise of Option
1. Whittmer-Jackson Co	Aug. 28, 1948	July 1, 1960
2. Ohio Machinery Co	Oct. 1948	Dec. 17, 1952
3. 7-Up Bottling Co	May 1949	Aug. 19, 1949
4. Century Food Markets Co	July 1949	Dec. 28, 1954
5. Paul M. Fithian	Nov. 1949	Sept. 1950

This case concerns the lease that taxpayer made with Century Food Markets Company (Century). Under the agreement, taxpayer, at a cost of $385,000, was to erect a warehouse and office building in accordance with certain revised plans and specifications prepared by an architect obtained by Century (R. 70a; Pet. 18). The lease was for 21 years (R. 70a;

Pet. 18) with rental payments as follows (R. 71a; Pet. 18):

First 6 years	$37,200 per annum
Next 5 years	$36,000 per annum
Next 5 years	$34,800 per annum
Next 5 years	$29,000 per annum

The lease also provided that Century was to have an option to purchase the buildings for $346,000, later increased to $347,625. The option could be exercised only at the end of the fifth year of the lease term. If Century did not exercise its option, the taxpayer could sell the leased premises on the open market at any time after the fifth year. (R. 71a; Pet. 18). Century exercised its option to purchase on December 28, 1954, the end of the fifth year of the lease (Pet. 18).

The Commissioner of Internal Revenue determined that taxpayer's profit ($134,292.39) from the sale to Century was taxable as ordinary income and not as capital gain. The Tax Court sustained the Commissioner's determination because the profit "was derived from property held by petitioner [taxpayer] primarily for sale to customers in the ordinary course of its trade or business" (R. 8a; Pet. 18–19). The court of appeals affirmed.

ARGUMENT

Section 1221(1) of the Internal Revenue Code of 1954, *supra*, excludes from the definition of a capital asset property held "primarily for sale to customers in the ordinary course of his [a taxpayer's] trade or business." Both courts below correctly held that the

property involved here was in that category, and there is no occasion for further review by this Court.

1. The decision below is not in conflict with that of any other court. In *Philber Equipment Corp. v. Commissioner*, 237 F. 2d 129 (C.A. 3), upon which taxpayer chiefly relies,[3] the Third Circuit held that the taxpayer was entitled to capital gain treatment upon the sale of certain trucks used in his motor vehicle rental business. The Commissioner had relied upon *Rollingwood Corp.* v. *Commissioner*, 190 F. 2d 263, where the Ninth Circuit held that the term "primarily," as used in § 1231, means "substantial" or "essential," rather than "principal." Without disputing the result reached in *Rollingwood* or even the definition there adopted, the court in *Philber* pointed out (237 F. 2d at 131) that "attempts to seek an alternative definition of the statutory word is an illusive guide to the solution of a problem which must rest upon the variation of facts presented," and hence that "[w]hether 'primarily' means 'substantial' or 'principal' is not dispositive" of the question presented. The basic problem in the case before it, in the court's view, was whether the vehicles were acquired by the taxpayer for the "dual purpose" of leasing and then selling them, or whether the ultimate sale was merely incidental to the "single purpose" of

[3] *Hillard* v. *Commissioner*, 281 F. 2d 279 (C.A. 5), also cited by the taxpayer, involved a factual situation almost identical to that in *Philber* and disposed of the legal issue largely on the authority of the Third Circuit's decision in that case. Accordingly, *Hillard* is no more in conflict with the decision below than is *Philber*.

operating a truck rental business. The sale would be decisive, the court said, only if the taxpayer's business was operated with the final business gains from the sale of the vehicles "as a determining business purpose."

Whatever its merits, *Philber* is plainly not in conflict either with *Rollingwood* or, more important, with the decision below. And any difference in approach there may be between the Third and Ninth Circuit cases is of no assistance to the taxpayer here, since it is clear he could not prevail under either of them. Indeed, the test adopted by the court below is virtually the same as that applied in *Philber*. Here, as there, the court noted that "We do not consider that any distinction between 'primarily,' or 'essentially,' or 'substantially' is a controlling consideration in this case. The sale of real estate appears to have been a primary, as well as an essential, or substantial, part of the [taxpayer's] business * * *" (Pet. 19). Like the Third Circuit, the court below recognized (Pet. 19) that a corporation may have a "dual purpose—or, two purposes, one of which is equally as important as the other." And while the court below was prepared to treat the sale proceeds as ordinary income upon a showing that the sale of the property was "a" primary part of the taxpayer's business, the Third Circuit would have reached the same result had it been satisfied that the sale of the vehicles was "a determining business purpose."

2. There is no basis for the contention that the decison below "will furnish grounds for the Commis-

sioner of Internal Revenue to deny capital gains treatment to every corporate taxpayer whose charter contains" general language such as that contained in the taxpayer's charter here (Pet. 15). The taxpayer's corporate purposes, as set forth in its charter, were only one of many factors properly taken into account by the district court. The other considerations were summed up in the concluding paragraph of the court of appeals' opinion (Pet. 20) and provide an entirely adequate basis for the decision:

> Considering the corporate objectives of Meridian, Inc.; the construction of the buildings for the special convenience and use of the various lessees in accordance with their plans and specifications; the right reserved to Meridian, Inc. to sell the properties at any time after the first five-year period of the leases, if the options to purchase were not exercised at that time; the exercise of the options, and the sale of the properties; we are unable to conclude that, under the applicable statute, the Tax Court was clearly erroneous in its determination that one of the primary or essential purposes of Meridian, Inc. was the holding of property for sale to customers in the ordinary course of its trade or business, and that the gain realized from its sale to Century Markets was ordinary income.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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